Public Policy 290 – Introduction to Tax Policy

Lecture 1: Income and wealth in the United States

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Roadmap

1. What is this course about?

2. Course organization: grading, readings, etc.

3. Income in the United States

4. Wealth in the United States

1   What is this course about?

Tax system is one of the key institutions of modern democracies:

- People pool 30%–50% of their income through government

- Funds education, health, infrastructure...: key engines of growth

- Regulates inequality, directly & indirectly by affecting incentives

- Taxes keep being re-designed to adapt to changes in politics, ideology, social and economic life

Taxes, according to Joseph Schumpeter, are "the thunder of world history:"

"The spirit of a people, its social structure, the deeds its policy may prepare, all this and more is written in its fiscal history, stripped of all phrases. He who knows how to listen to its message here discerns the thunder of world history."

Top marginal tax rates in the US
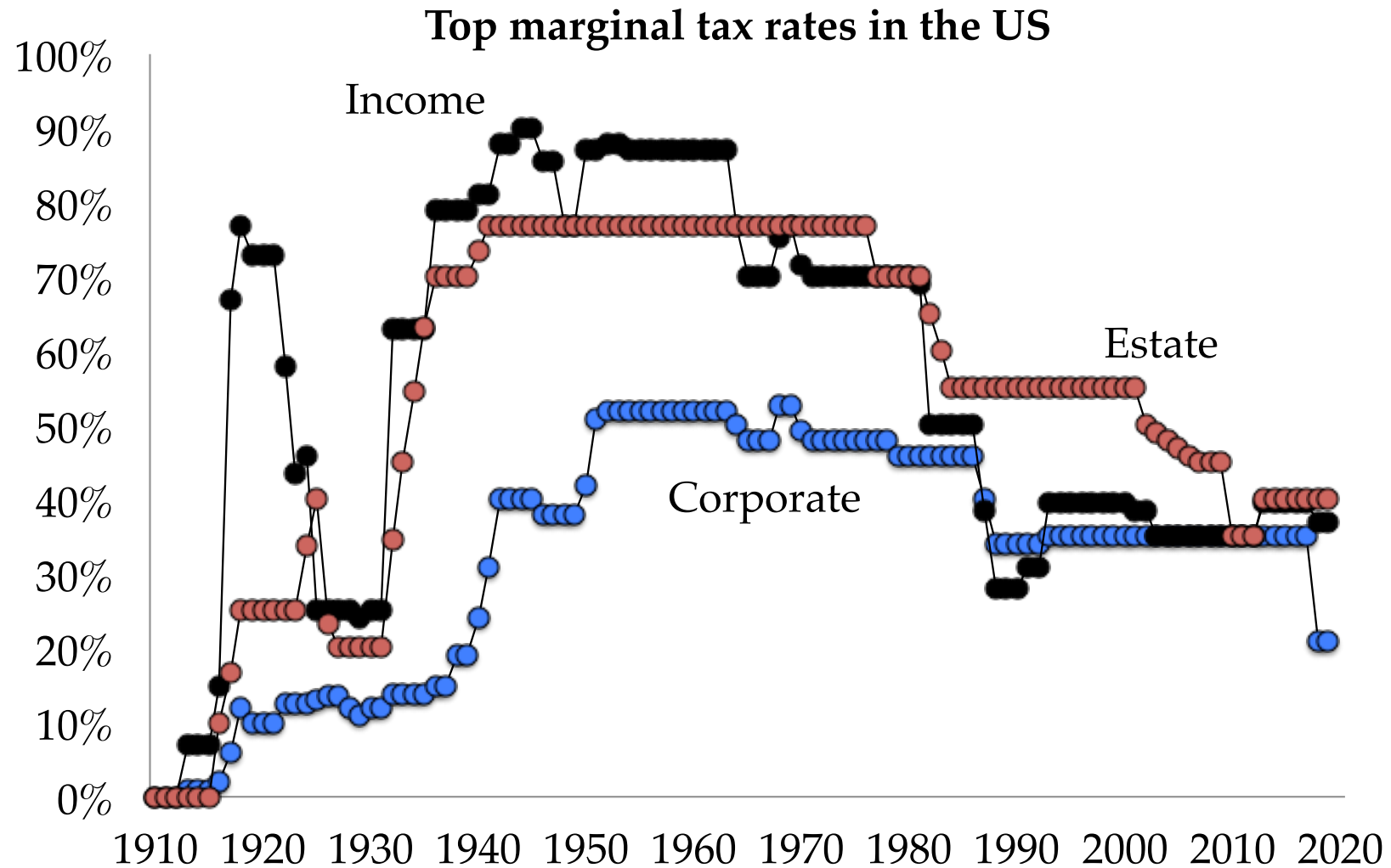
1.1   Key questions tackled in this course:

- Who pays what in taxes?

- How has tax progressivity changed over time in the US?

- What are the merits and demerits of taxing income? Wealth? Consumption?

- Is it possible to tax capital in a globalized world?

- What does the ideal tax system look like?

2 Organization of the course

2.1 Lectures

- 7 topics: 1 topic per lecture each Wed. 12-2pm

- Lecture slides: `http://gabriel-zucman.eu/pp290`

- Textbook: E. Saez and G. Zucman, *The Triumph of Injustice*, WW Norton, 2019.

- We'll follow the structure of the book. Slides cover main points only: important to read book

Seven lectures:

- Income and wealth in the United States

- The US tax system: who pays what? (chapter 1)

- Tax progressivity: a historical and international perspective (chapters 2-3)

- Labor and capital taxation (chapter 4)

- Global tax competition (chapter 5-6)

- **Progressive income, wealth & inheritance taxation: the ideal triptych? (chapters 7-8)**

- **Funding the social state (chapter 9)**

2.2 Teaching team and grading

- Reader: Reem Rayef

- My office hours: by appointment

- Grading: one term paper (4–5 pages)

- Choose a theme related to material covered in the course; check with teaching team first

3   Income and wealth in the United States

3.1   The notion of national income

- National income includes all the income that accrues to residents in a given year, whatever legal form this income takes

- Average national income in the US 2019: $75,000 per adult

- Closely related to GDP: National income = GDP – depreciation + net foreign income

- GDP/adult higher in the US that in most other OECD countries

- … But this is mainly because of more hours worked

- GDP per hour worked is similar in US, Germany, France, Scandinavia, etc. (around $80)

- I.e., productivity is about the same in these countries, but Americans work more (start working earlier, end later in life, less parental leave, longer workweeks)

3.2   National income vs. fiscal income

- Fiscal income = income subject to the individual income tax

- Only 60%–65% of national income, because of tax evasion and legal exemptions

- Tax evasion: IRS random audit studies estimate that about 13% of true taxable income is unreported

- Legal exemptions: many differences between economic income and taxable income

Mains forms of tax-exempt income in the US:

- Employment benefits (contributions to health care and pensions)

- Dividends and interest earned on retirement accounts

- Undistributed corporate profits (tech companies)

- Most housing rents (owner-occupied housing + generous depreciation rules)

A growing fraction of US national income is tax exempt:

- Rising health care premiums

- Rising pension wealth

- Growing generosity of business depreciation rules (bonus depreciation, full expensing since 2018)

$\rightarrow$ Despite "base broadening" rhetoretic, US is taxing a smaller and smaller fraction of aggregate income

3.3   The distribution of national income

Useful to divide adult population in four (heterogenous) groups:

- Bottom 50% ("working class"): average pre-tax income = $18,500

- Next 40% ("middle class"): $75,000

- Top 10% excet top 1% ("upper middle class"): $220,000

- The top 1%: $1.5 million

3.4   Changes in the distribution of national income

- Well known increase in income inequality in the US

- True whether one looks at fiscal income or national income (Piketty, Saez and Zucman, 2018)

- True whether one looks at pre-tax income or post-tax-and-transfer income ("post-tax income")

- Larger increase in the US than in other developed countries (see World Inequality Report 2018)

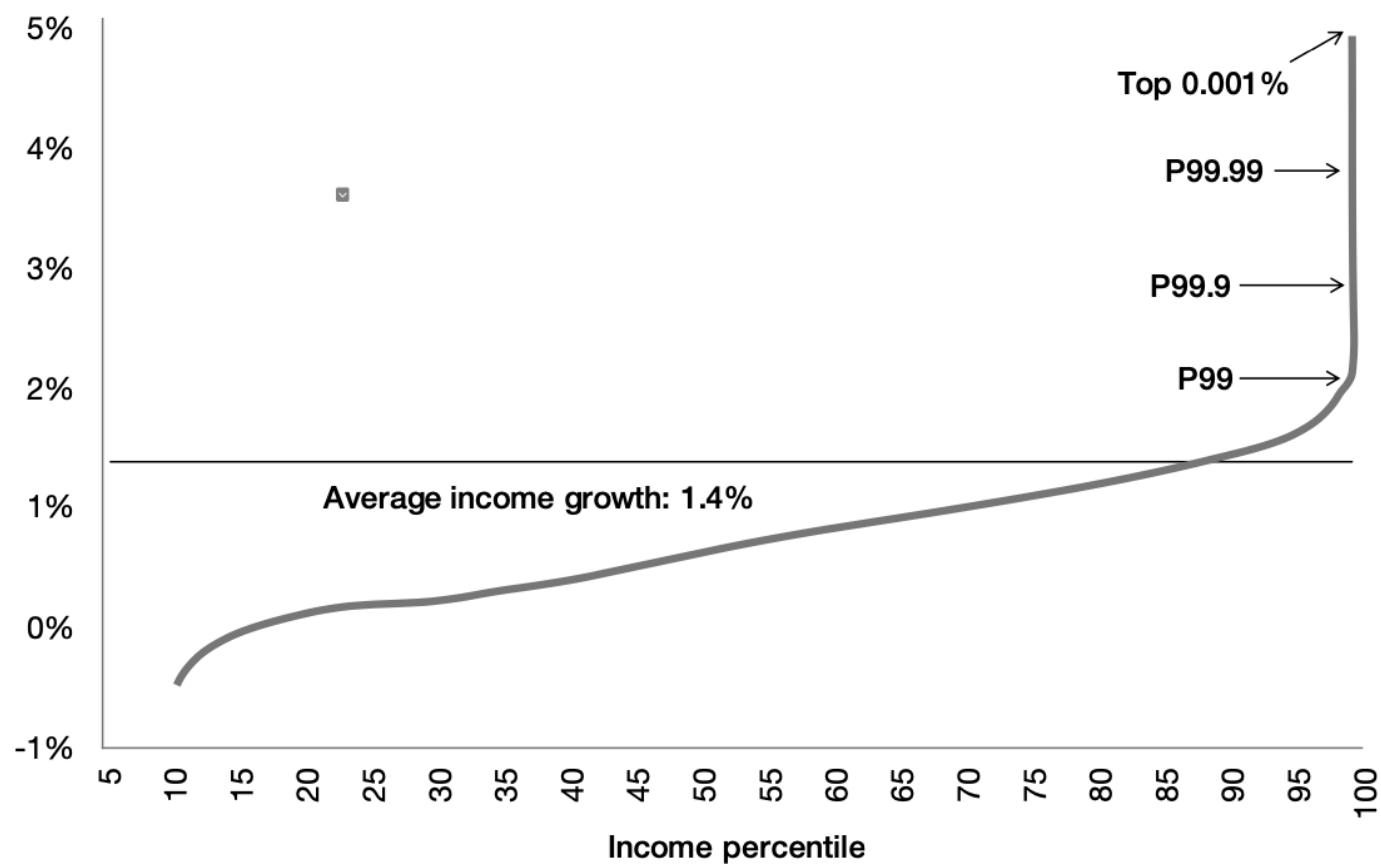(Share of national income earned by the top 1% vs. bottom 50%)
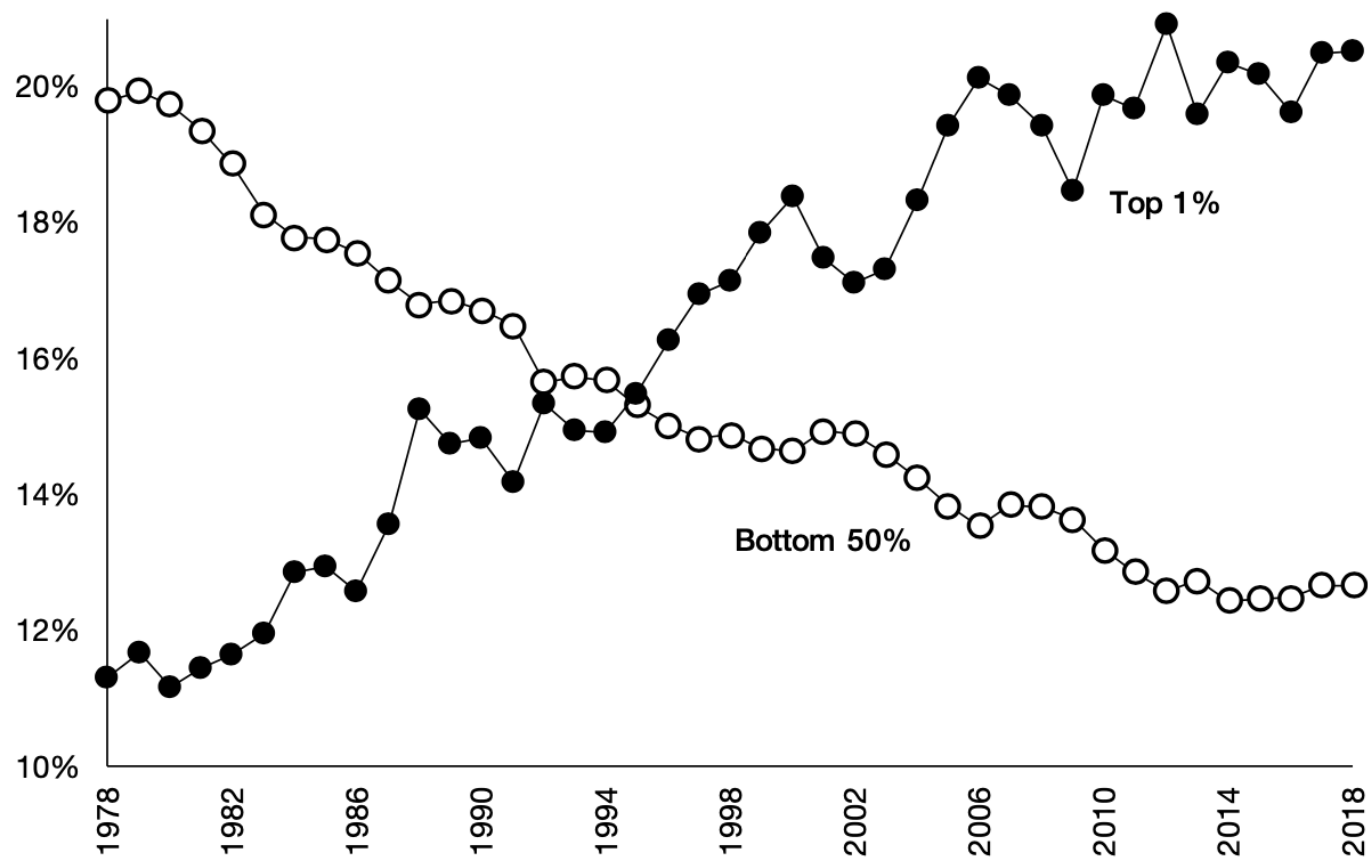
Notes: The figure depicts the share of pre-tax national income earned by the bottom 50% income earners and the top 1% earners since 1978. The
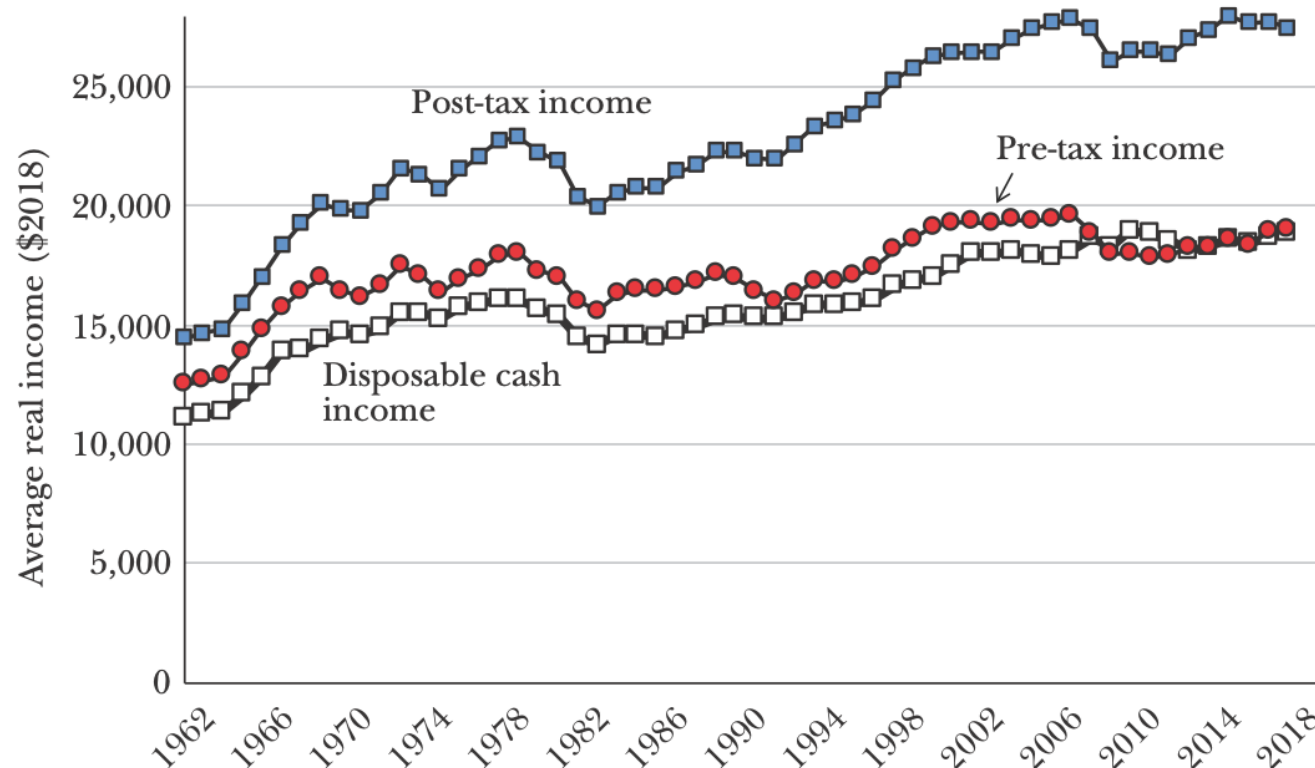
Annual growth of pre-tax income by income group, 1946–1980
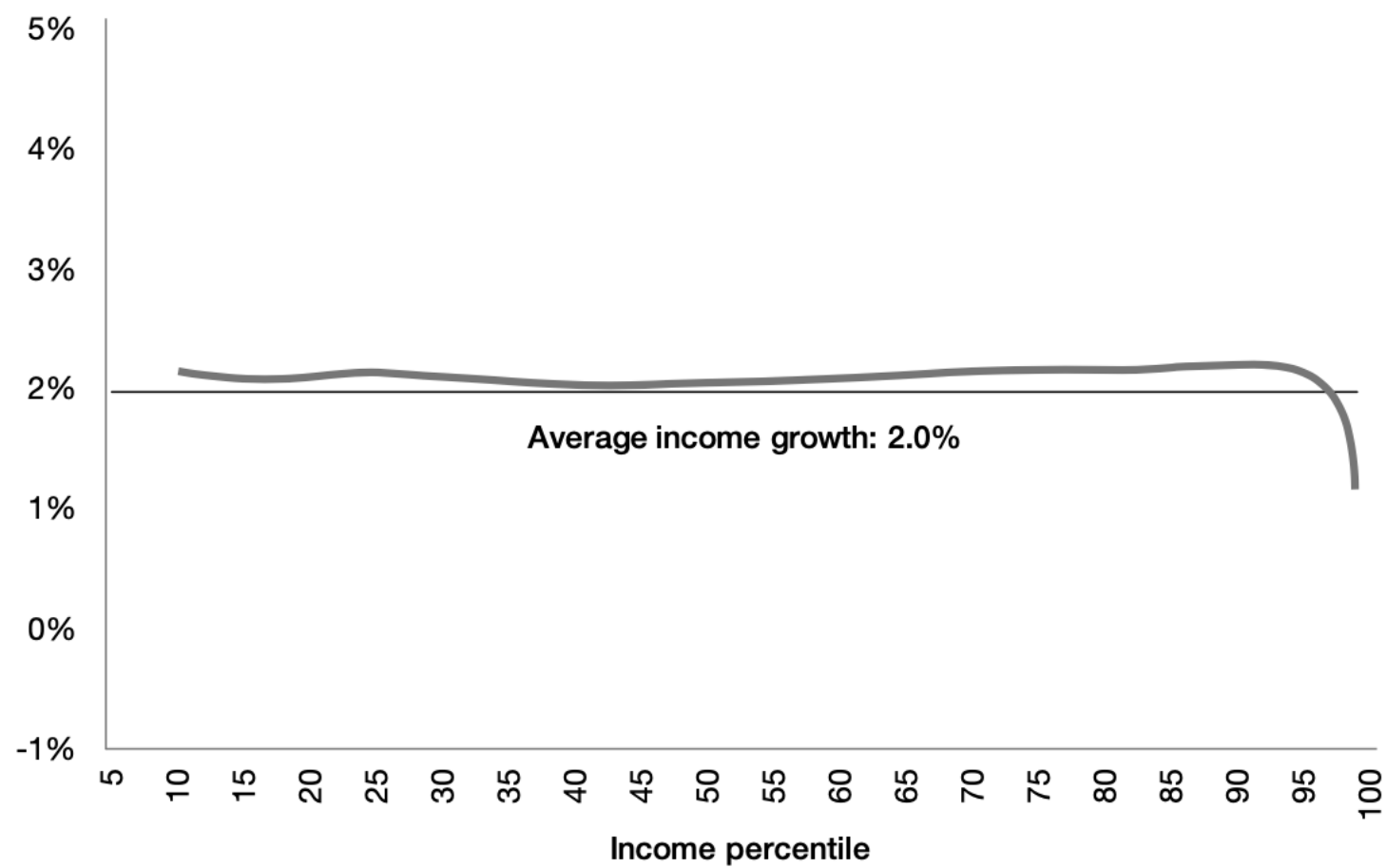
Annual growth of pre-tax income by income group, 1980–2018

Average income growth: 1.4%

Top 0.001%

P99.99 ⟶

P99.9 ⟶

P99 ⟶

Income percentile

The Evolution of Bottom 50 Percent Incomes

Source: Piketty, Saez, and Zucman (2018), updated September 2020.
Note: The figure depicts the evolution of the real incomes per adult (in 2018 dollars) for the bottom half of the income distribution for three income concepts: (1) pre-tax income before deducting taxes or adding government transfers (concept sums up to national income), (2) post-tax income that deducts all taxes and adds all transfers (cash and in-kind) and collective public expenditures minus the government deficit (also sums up to national income), (3) disposable cash income which is pre-tax income minus all

4   Wealth in the United States

- Private wealth W = assets – liabilities of households

- Assets = all non-financial (housing, land...) and financial assets (equities, bonds, bank deposits...)

- Recorded in Federak Reserve Financial Accounts

- Public wealth = assets – liabilities of the government (public debt)

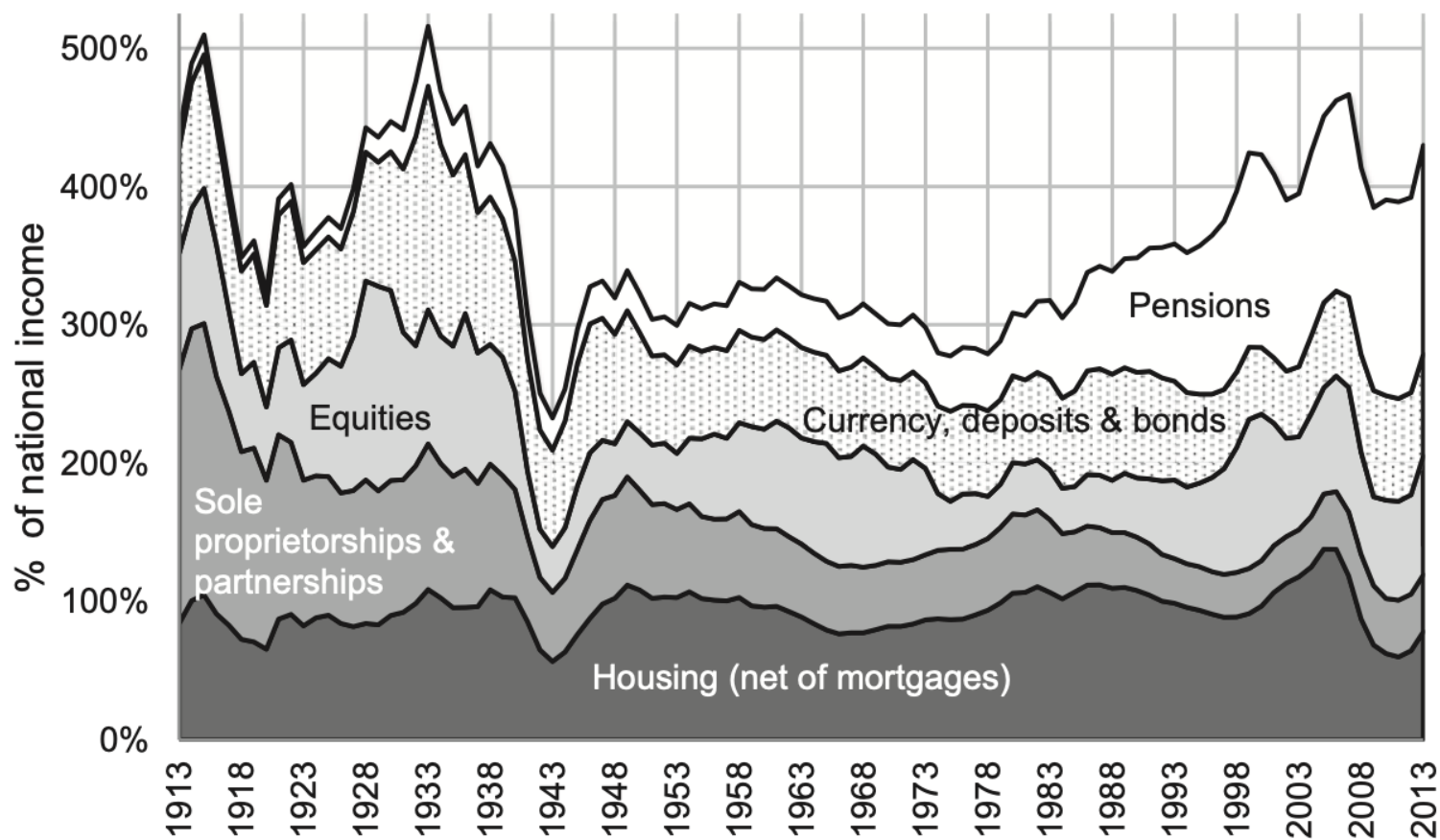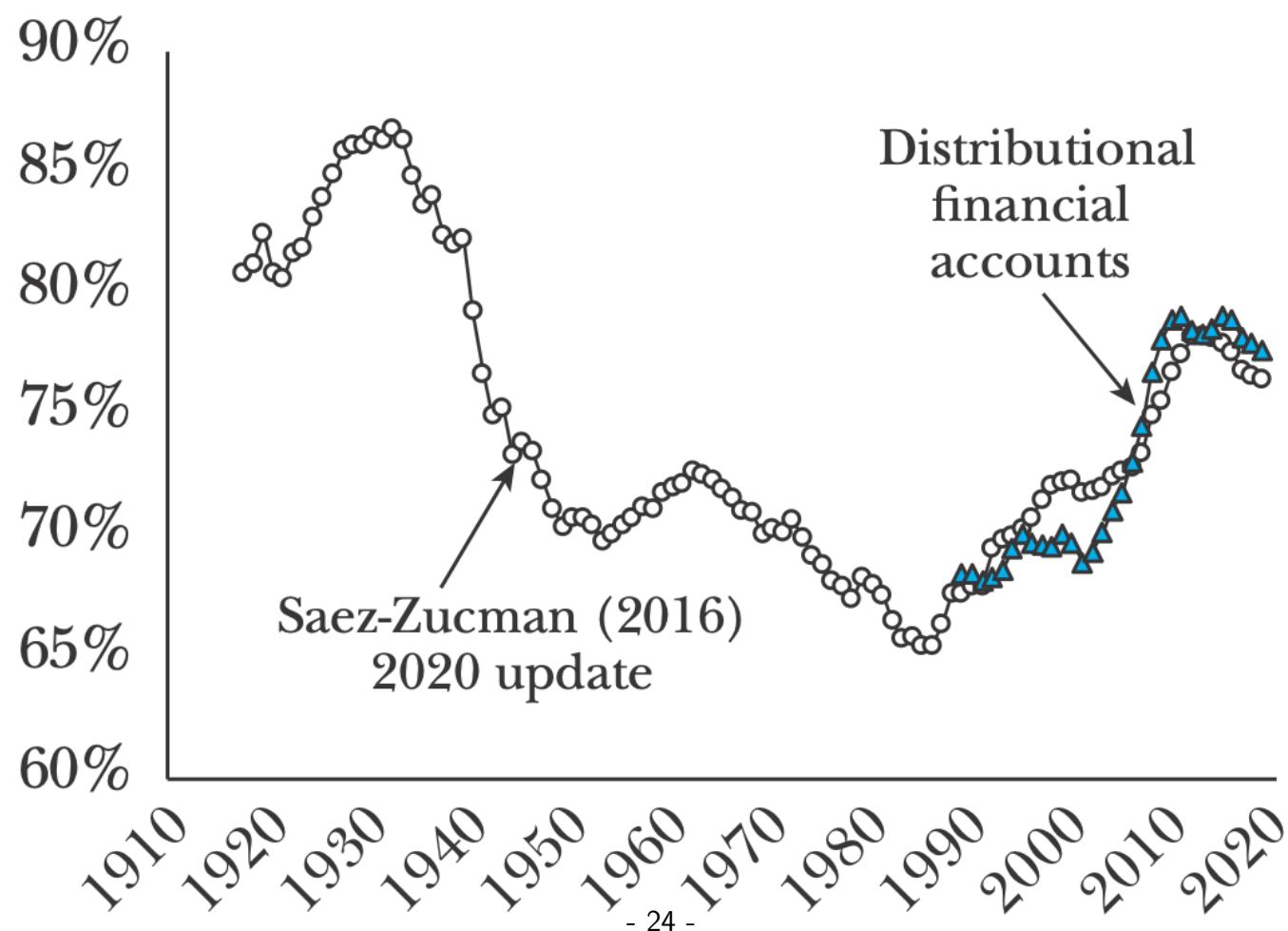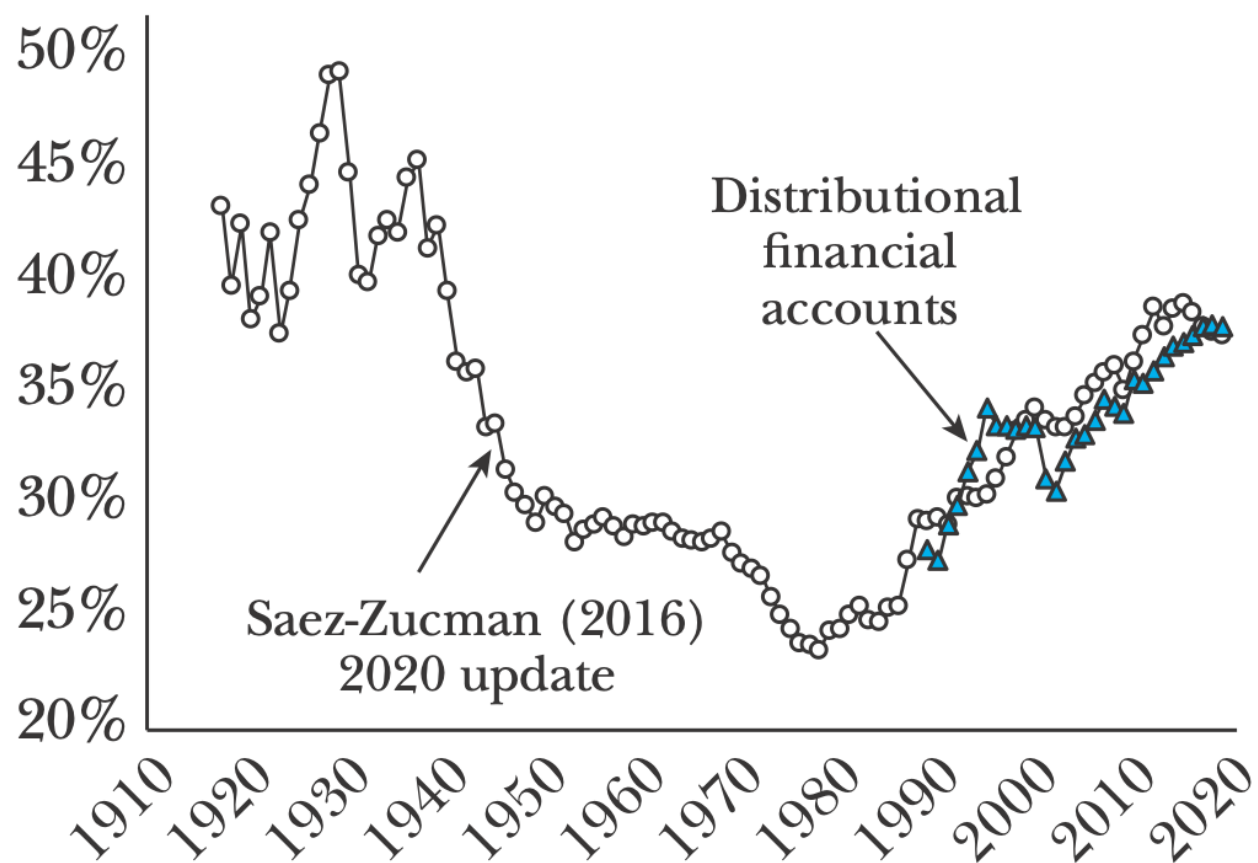- National wealth = private wealth + public wealth

FIGURE II

Aggregate US Household Wealth, 1913–2013

Top 10% wealth share
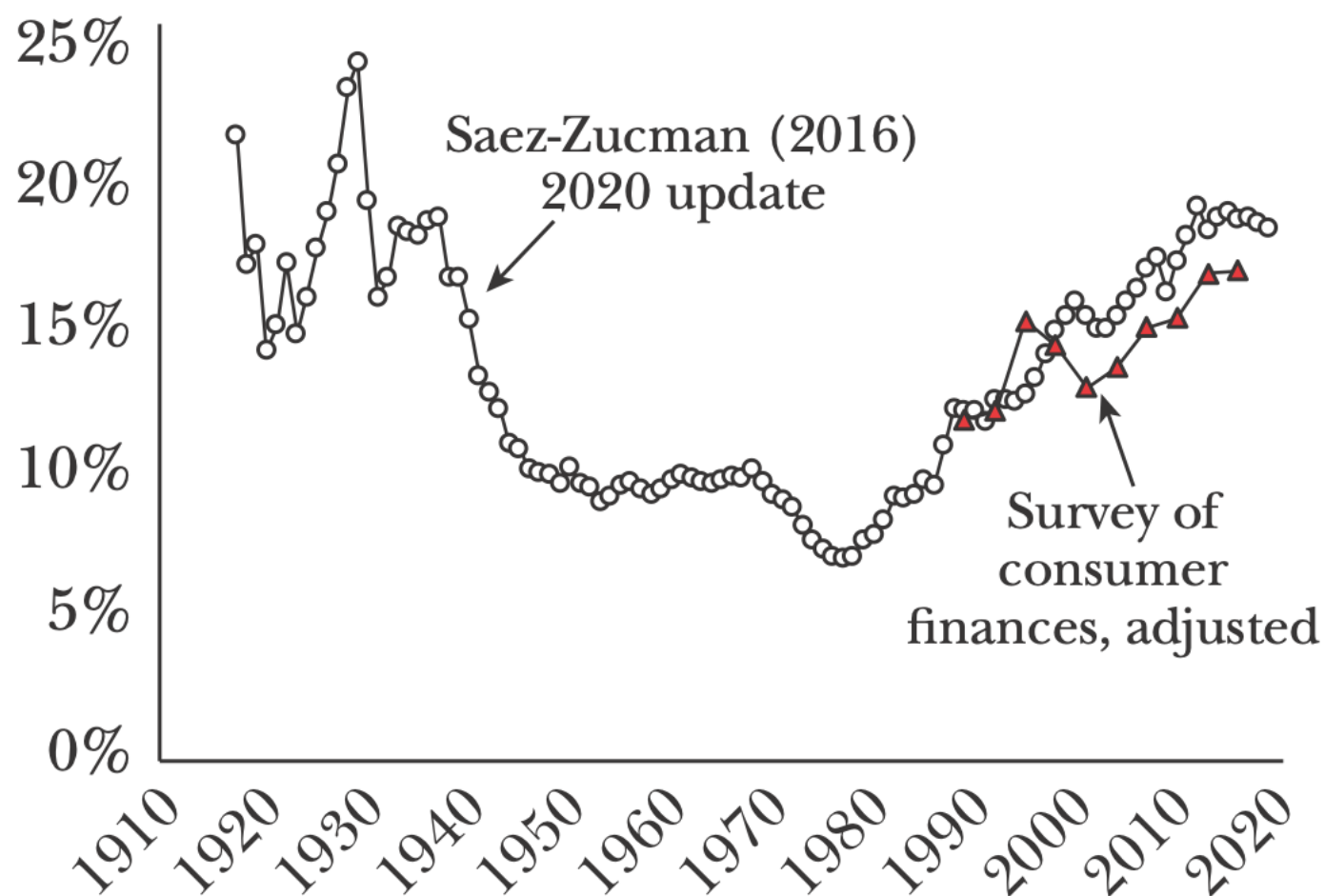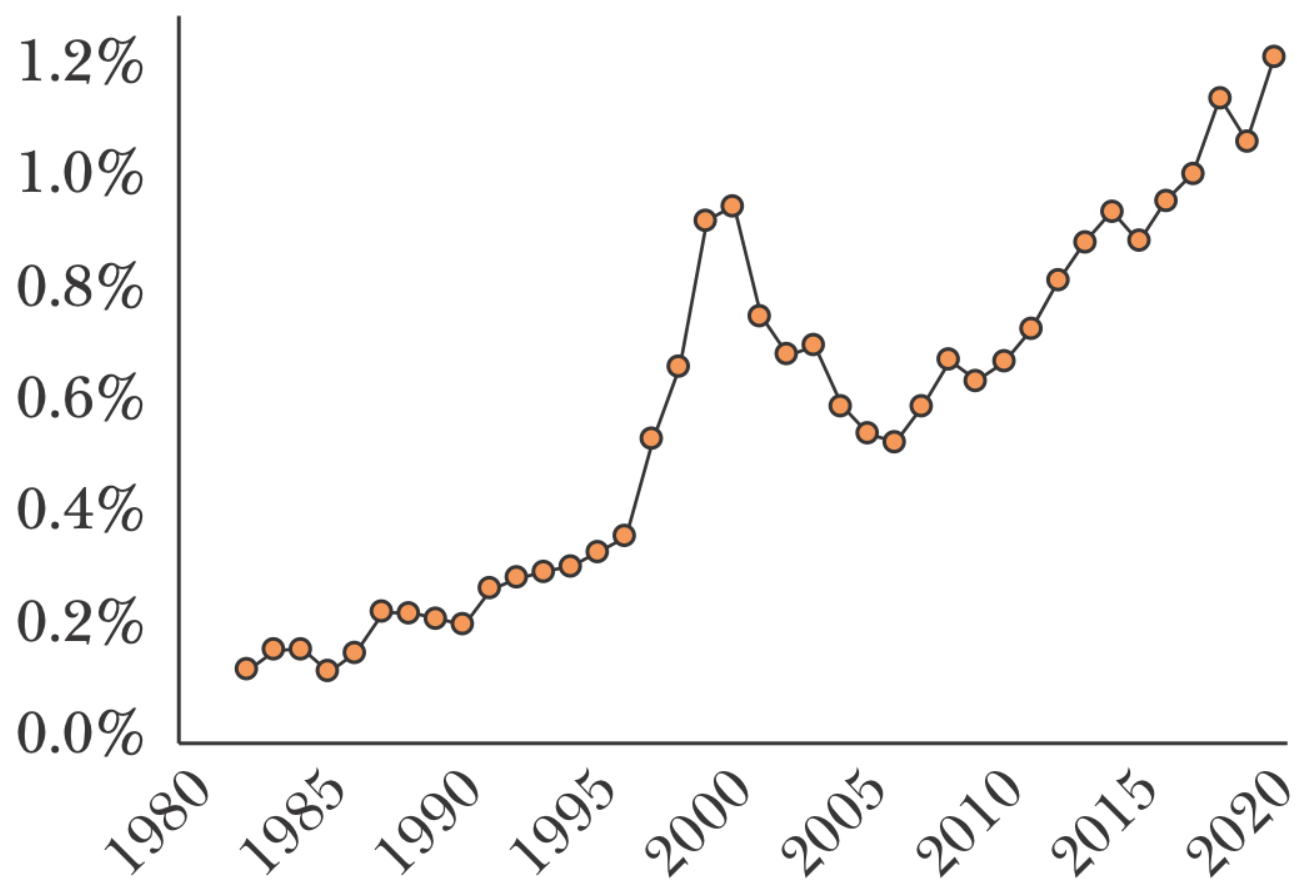
Top 1% wealth share

Top 0.1% wealth share

Top 0.00001% wealth share

References

Piketty, Thomas, Emmanuel Saez, and Gabriel Zucman, "Distributional National Accounts: Methods and Estimates for the United States," *Quarterly Journal of Economics*, 2018 (web)

Saez, Emmanuel and Gabriel Zucman, "The Rise of Income and Wealth Inequality in America: Evidence from Distributional Macroeconomic Accounts," *Journal of Economic Perspectives*, 2020 (web)